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IN THE

# Supreme Court of the United States

Docket No. 472
October Term, 1964

ROBERT P. McCULLOCH,

*Plaintiff and Appellant,*

*vs.*

CALIFORNIA FRANCHISE TAX BOARD,

*Defendant and Appellee.*

## APPELLANT'S REPLY TO APPELLEE'S MOTION TO DISMISS.

The sole issue raised by the Motion to Dismiss filed by the California Franchise Tax Board (hereinafter called "Appellee") is that "there is no substantial federal question presented" because the issues here "have been foreclosed by previous decisions of this Court." (Motion to Dismiss, p. 1.)

Appellant suggests that the federal questions here *are* substantial:

1. The issues involved in this case have never been decided before. (See Jurisdictional Statement, pp. 14-15; this point is conceded by Appellee, see Motion to Dismiss, p. 5.)

2. The issues involved in this case are important because of the increasing incidence of out-of-state trusts and the increased use of accumula-

tions trusts. (Jurisdictional Statement, pp. 15-16; no comment in Motion to Dismiss.)

3. No case in this Court has ever extended the constitutional concept of *nexus* so far as it was extended in this case. (Jurisdictional Statement, pp. 16-20.)

4. In two respects at least the Court below disregards statutory limitations imposed upon taxation by local law. (See Jurisdictional Statement, pp. 20-21 (100% tax based on residence of one-third of trustees), and pp. 21-22 (judicially-imposed "throwback" four years before enactment of same).

*Nexus-preliminary.* Since everyone agrees that the tax liability here imposed was a transferee liability—

Appellant (see Jurisdictional Statement, p. 9);
Appellee (see Motion to Dismiss, p. 3);
Court below (see Jurisdictional Statement, App. A, p. 8, lines 24-26, and p. 14, lines 14-17),

then the only tax under attack here is the initial tax on the *trust* for income it received. This is the tax which, in the words of the Appellee, "the trustee should have paid on behalf of the trust as that income was earned." (Motion to Dismiss, p. 3.)

The constitutional issue is whether, "as that income was earned" in 1946-1950, sufficient connection then existed between California's tax on the trust and "transactions within [California] for which the tax is an exaction." *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 445 (1940). But in our case the assertedly taxable transaction, the receipt of income each year from 1946 to 1950, was not a transaction which took place in California.

Appellee says *no* transactions are necessary—that "appellant's residency in California in his capacity as the contingent beneficiary and as one of the three trustees" is sufficient to justify the tax on the trust (Motion to Dismiss, p. 4, lines 21-30).

*Nexus-residence of prospective distributees.* Appellee refers to California's "benefits and protection" accorded the non-recipient contingent beneficiaries and to the "many 'connections' with the accumulated income and the trust." (Motion to Dismiss, p. 6.) But the decisions of this Court, even those relied upon by Appellee, require a protection more relevant to the taxable transaction in question than that enumerated by the Appellee or by the decision below. *Maguire v. Trefry*, 253 U. S., 12, 14 (1920) and *Lawrence v. Tax Commission*, 286 U. S. 276, 281 (1932) required protection afforded "the recipient of the income"; and *Guaranty Trust Co. v. Virginia*, 305 U. S. 19, 23 (1938) taxed "receipt of income within Virginia".

These cases do not justify imposing a tax on a *trust* for out-of-state income because of the residence of a *beneficiary* who does not receive the income "as earned."[1]

Appellee's rejoinder is that California accorded the prospective beneficiaries (Appellant and his heirs) "the interim protection of its laws"—kept them alive and "extended the shelter of its governmental institutions" while Appellant was awaiting age 40 or while his heirs

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[1]It is immaterial how the technical future interest of Appellant during 1946-1950 was characterized—"contingent," "vested" or otherwise. In this we agree with Appellee (Motion to Dismiss, p. 11). The point is that during those years it was the *trust* which received the "income as earned"; Appellant did not receive it then, and he was only a prospective distributee in the future.

awaited his earlier demise. (Motion to Dismiss, p. 6, lines 17 *et seq.* quoting opinion below, Appendix A of Jurisdictional Statement, p. 12.)

No case has ever held that keeping prospective distributees alive is a sufficient connection with the taxable transaction—receipt of income by the trust—to justify a tax on the trust income "as earned". No case has ever held that the court protection afforded a *non*-recipient of income justifies a tax on that income against the *recipient*—even where, as here, the relationship between recipient and non-recipient is as close as that of a trust and its prospective beneficiaries. Compare *West Publishing Co. v. McColgan*, 27 Cal. 2d 705, 713 (*aff'd.* 328 U. S. 823), cited by Appellee (Motion to Dismiss, p. 8), where the court protection *was* afforded the recipient of the income taxed, with *Miller Bros. v. Maryland*, 347 U. S. 340, 347 (1954), striking down a state's attempt to shift to a foreign vendor the tax it could not successfully enforce against its own residents, who bought from the vendor.

> "* * * That these inhabitants incurred a liability for the use tax, that they used, stored, or consumed the goods in Maryland, no one doubts. But the burden of collecting or paying their tax cannot be shifted to a foreign merchant in the absence of some jurisdictional basis not present here." 347 U. S. at 347.

*Nexus-residence of one-third of trustees:* This, suggests Appellee, supplies any deficiency in constitutional relationship (Motion to Dismiss, p. 10), on the theory that Appellant, as trustee, could enforce the trust's rights in California. Conceding this *arguendo* (we disagree with much of what is said in this context

by Appellee), yet the residence of only one of three trustees by specific statute (see Jurisdictional Statement, p. 20) at most entitles California to tax one-third of the income—not all of it.

*Control.* Appellee frequently suggests (Motion to Dismiss, p. 7, lines 19-24, and p. 11, lines 2-5) that the sibling relationship of Appellant with one of two co-trustees gave him "effective control" over the trust. (This was not a ground of the decision below, despite Appellee's similar argument.) Had the control been as strong as Appellee's counsel implies, it would have permitted Appellee to attribute the subject income to Appellant in the years earned—even though accumulated into trust corpus—and to assert a direct income tax liability against Appellant, not a transferee liability. *Cf. Mallinckrodt v. Commissioner*, 146 F. 2d 1 (8th Cir., 1945), *cert. denied* 324 U. S. 871.

## Summary.

Appellant says that the residence of non-recipient prospective beneficiaries in 1946-1950 is not enough to permit California to tax income received and accumulated by the trust in Missouri in those years. Appellant says that the residence of a single trustee (of three) is not enough to support total taxation of income accumulated by the out-of-state trust, especially where California law, if valid at all, only permits imposition of a tax on one-third of that income in such circumstances.

Appellant respectfully suggests that the questions involved are sufficiently substantial to warrant consideration of this appeal by this Court.

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